BANGKO SENTRAL NG PILIPINAS

HIGHLIGHTS OF THE MEETING OF THE MONETARY BOARD ON THE MONETARY POLICY STANCE HELD ON 12 MAY 2016[1]

I. Monetary Policy Decision

The Monetary Board (MB) decided to:

a) Maintain the BSP's key policy interest rates at 4.00 percent for the overnight RRP (borrowing) facility and 6.00 percent for the overnight RP (lending) facility;

b) Maintain the current interest rates on term RRPs, RPs and SDAs; and

c) Maintain the current reserve requirement ratios.

II. Key Considerations in the Formulation of the Monetary Policy Stance

- The Monetary Board's assessment of a manageable inflation outlook and robust growth conditions continues to support keeping monetary policy settings unchanged.
    - Average inflation is projected to settle within the target range of 3.0 percent ± 1 percentage point for 2016-2017, while inflation expectations continue to be firmly anchored within the inflation target band over the policy horizon. At the same time, inflation continues to be driven mainly by supply-side factors.
    - The risks surrounding the inflation outlook have remained tilted to the downside, with potential downward price pressures associated with slower-than-expected global economic activity and possible second-round effects from lower international oil prices. Upside risks could come from the impact of El Niño dry weather conditions on food prices and utility rates as well as pending petitions for power rate adjustments.
- The Monetary Board also recognized that global economic conditions have become weaker since the previous meeting on the monetary policy stance. Nonetheless, prospects for domestic economic activity remain robust, supported by solid private household consumption and investment, buoyant business sentiment, and adequate credit and domestic liquidity. Higher public spending is also expected to boost domestic demand.

[1] The discussions herein reflect the assessment made by the Monetary Board based on a comprehensive set of economic information available at the time of the policy meeting. The highlights of the discussions during the 12 May 2016 meeting were approved by the Monetary Board during its regular meeting held on 9 June 2016. The next meeting of the Monetary Board on monetary policy issues is scheduled on 23 June 2016.

III. Recent Developments and Inflation Outlook

The MB considered the following developments in deciding on the monetary policy stance:

A. Domestic price conditions

- April inflation held steady at 1.1 percent from the same rate in March, as inflation for food and non-alcoholic beverages remained unchanged while non-food inflation only posted a marginal increase compared to the previous month's level. Higher price increases of key food items such as meat, vegetables, fruits, as well as oils and fats offset the continued decline in rice prices compared to their year-ago levels. Likewise, higher year-on-year inflation rates from non-food items (clothing and footwear, health, recreation and culture, as well as restaurant and miscellaneous goods and services) tempered the negative inflation outturn in housing, water, electricity, gas and other fuels during the month.

- Most indicators of core inflation, including the official rate, trimmed mean, and net of volatile items, were also steady in April. Meanwhile, the number of CPI items with inflation rates below the threshold declined during the month relative to the previous month.

- By geographical location, inflation in the National Capital Region (NCR) increased to 0.4 percent from 0.2 percent, while inflation in areas outside NCR remained the same as the previous month's rate at 1.3 percent.

B. Inflation expectations

- Inflation expectations remain consistent with the within-target inflation outlook. For April 2016, results of the BSP's survey of private economists showed unchanged mean inflation forecasts for 2016 and 2017 at 1.9 percent and 2.7 percent, respectively, relative to the March 2016 survey. Meanwhile, results of the April 2016 Consensus Economics inflation forecast survey showed lower mean inflation forecasts for both 2016 and 2017 at 1.9 percent (from 2.2 percent in March) and 3.0 percent (from 3.1 percent in the previous month), respectively.

C. Inflation outlook

- The latest baseline inflation forecasts for 2016-2017 are broadly unchanged compared to the previous forecast round, as the impact of the increase in oil prices and higher-than-projected inflation outturn for March 2016 was offset by expectations of slower global economic activity and a stronger peso.

- The prevailing balance of risks to future inflation remains tilted to the downside. Slower global economic activity and potential second-round effects coming from persistently low international oil prices pose downside risks, while pending petitions for adjustments in electricity rates and the impact of El Niño conditions on food prices and utility rates are seen as key upside risks to inflation.

D. Demand conditions

- Latest indicators of domestic demand continued to point to firm growth prospects over the policy horizon. The Philippine composite purchasing managers' index (PMI) remained above the 50-point expansion threshold at 56.1 as of March. The latest results of the BSP's Consumer Expectations Survey (CES) also indicated improved sentiment for Q1 and Q2 2016. Fiscal spending also increased by 15 percent year-on-year in January 2016.

E. Supply-side indicators

Developments in Agriculture

- The average retail price of rice was slightly higher in April relative to the previous month as *palay* production declined due to the lack of rainfall and intense heat brought about by dry weather conditions during the recent optional cropping season.

- International food prices were likewise broadly higher in April. The Food and Agriculture Organization (FAO) food price index (FPI) averaged 151.8 points in April, higher than the average of 150.6 points in the previous month. The marginal increase was attributed to the higher prices of cereals, vegetable oil, and meat, which outweighed the decline in the prices of dairy and sugar products.

- The strong El Niño continues to weaken and majority of climate models suggest that the condition in the tropical Pacific will return to neutral levels by mid-2016. However, the chance of a La Niña episode in July-August-September 2016 has increased.

Oil Price Developments

- Dubai crude oil prices continued to rise in April. While negotiations for a possible output freeze agreement among major oil producers resulted in an impasse, oil prices were bolstered by supply disruptions in Kuwait due to a workers' strike and by the reduced tight oil output in the US.

- Global oil supply is still expected to outstrip global oil demand for the rest of 2016. Nonetheless, the gap could narrow in 2017, with demand projected to exceed supply by the second half of the year as shale oil production in the US declines. Meanwhile, higher oil demand in 2017 could be attributed to higher consumption in the Middle East, Eurasia, and the US, although lower oil demand in China and Japan continued to pose a downside risk to global oil demand.

Developments in the Utilities Sector

- Electricity rates increased in April due to higher generation costs. According to Meralco, the increase in generation costs was driven mainly by higher charges from the Wholesale Electricity Spot Market (WESM) due to the surge in demand amid the summer season. Water rates likewise increased during the month due to higher foreign currency differential adjustments.

F. Financial market developments

- The global and domestic financial environment remained generally calm in April. Cautious trading reined in gains in the Philippine equities market towards the latter part of the month. Nonetheless, the sustained inflows of foreign exchange from overseas Filipino remittances, foreign direct and portfolio investments, BPO and tourism receipts, as well as the ample level of the country's gross international reserves and the country's robust economic growth provided stability to the peso. Debt spreads also narrowed as market participants welcomed further monetary stimulus measures from the People's Bank of China and the further easing of monetary policy settings by the European Central Bank.

G. Domestic liquidity and credit conditions

- Liquidity and credit are growing at a reasonable pace. Domestic liquidity (M3) grew by 11.7 percent year-on-year in March to reach ₱8.5 trillion. This was faster than the 11.2-percent (revised) year-on-year expansion recorded in February. On a month-on-month seasonally-adjusted basis, M3 increased by 1.7 percent. Money supply continued to expand due largely to sustained demand for credit.

- Outstanding loans of commercial banks, net of reverse repurchase (RRP) placements with the BSP, expanded by 14.8 percent year-on-year in March from 16.9 percent year-on-year in February. Similarly, bank lending inclusive of RRPs increased by 13.5 percent year-on-year in March from 15.7 percent year-on-year in the previous month. On a month-on-month seasonally-adjusted basis, commercial bank lending increased by 0.3 percent for loans net of RRPs and by 0.1 percent for loans inclusive of RRPs.

H. Fiscal developments

- The National Government (NG) recorded a fiscal deficit of ₱3.47 billion in January 2016, lower by 46 percent from the ₱6.47-billion deficit incurred in the same month in 2015. Excluding the interest payments from total NG expenditures, the primary surplus amounted to ₱42.1 billion, ₱2.8 billion or 6.0 percent lower than the level recorded in the same period a year ago.

I. External developments

- The JP Morgan Global All-Industry Output Index rose to 51.3 in March from 50.8 in February as output growth accelerated in both the manufacturing and service sectors. Output growth was faster in the US, euro area, UK, and Russia. By contrast, the pace of production held steady in Japan, while the downturn in Brazil continued. Indicators also continued to point to subdued economic activity in China.

- Meanwhile, the IMF downgraded its global growth projections for 2016 and 2017, taking into account a possible renewed episode of financial market volatility, the loss of growth momentum in advanced economies, and continuing headwinds in emerging economies at the onset of 2016. Moreover, downside risks to the outlook have become more apparent. While market sentiment has calmed down in recent months, the renewed episode of financial market volatility earlier in the year point to a need to further bolster confidence.

- Most central banks in Asia maintained their monetary policy settings in April and early May. By contrast, the Reserve Bank of India (RBI) and the Reserve Bank of Australia (RBA) both decided to ease their monetary policy settings to provide support to their respective domestic economies. The RBA, in particular, also noted its concerns over low inflation. Meanwhile, Bank Indonesia (BI) announced some operational adjustments, shifting its key policy rate from the BI rate to the 7-day reverse repo rate starting in August 2016 to enhance the transmission of monetary policy. Meanwhile, the US Fed left its policy rate unchanged on 27 April.